

Congress of the United States
CONGRESSIONAL OVERSIGHT PANEL

Opening Statement of Kenneth Troske

Congressional Oversight Panel Hearing on the Use of Private Contractors in the TARP

September 22, 2010

Thank you Mr. Silvers.

I would like to start by thanking all of the witnesses for agreeing to come here today. Clearly our job as an oversight panel is made much easier with your help in understanding the issues surrounding TARP and contracting, and I want to let you know that I appreciate your efforts.

While I recognize that, at first glance, today's hearing on TARP's Exceptional Contracting Authority does not appear as exciting as some of the panel's previous hearings, once you begin to study the issues surrounding contracting—including such issues as when and why the government decides to do work internally verses hiring an outside contractor, who the government hires as contractors, and the details of contractor compensation—you quickly discover that these issues are fundamentally important for understanding how to create a financial system that is less prone to crisis and less destructive when a crisis occurs. Through the very act of hiring businesses to work for the federal government, the government may implicitly be providing an advantage to one company relative to its competitors, and this arrangement potentially creates a type of moral hazard that can lead to problems in the market.

An important issue that seems to have received very little attention is when is it appropriate for the federal government to contract with firms that it regulates? For example, through the TARP the Treasury is currently contracting with several financial firms including BNY Mellon, Morgan Stanley and AllianceBernstein, and the government is often paying them at rates that are below what the firms could obtain performing similar work in the private sector. These firms often feel, perhaps correctly, that they are doing the government a favor. Suppose, however, that in the not too distant future one or several of these firms are found to be in financial distress or are discovered not to be in complete compliance with regulations. Is it hard to imagine that the current or recent work for government might influence how the regulatory authorities deal with the firm? In turn, might this preferential treatment provide the firm with a distinct advantage over a non-contracted competitor in the same situation? Further, as we all know, various government agencies are writing new rules in response to the recently passed Dodd-Frank Wall Street Reform and Consumer Protection Act. Again, it would not be too hard to imagine that, because some firms are working for the agencies that are writing these new rules, these firms

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may be able to have a greater influence on the rules than their competitors who are on the outside looking in. Finally, the line is not always clear between bailing out a firm when it gets into financial difficulty and awarding the firm a government contract. These types of ambiguous actions lead to questions about the government's ultimate motivation when contracting with firms such as Fannie Mae and Freddie Mac which recently received substantial financial support from the government.

These are examples of the moral hazard that may be created when the government hires private sector firms. If this moral hazard is recognized and priced by the market, this advantage is one more factor that contributes to the creation of systemically risky, too big to fail firms. The cost of this moral hazard needs to be considered when weighing the decision of whether certain tasks should be performed directly by the federal government or by outside contractors.

I want to be clear; I have no reason to suspect that the Treasury or any other government agency has behaved in an inappropriate fashion. However, I do believe that issues surrounding when it is appropriate for government agencies to hire heavily regulated firms as "outside contractors" should be discussed by policy makers, legislators and the American public. For all of these reasons, today's hearing is as important as the COP's previous hearings on examining the bailout of large banks, the bailout of AIG, and the use of TARP to support the auto industry. While I don't think we are going to develop definitive guidelines for when the government should contract with private sector firms, hopefully the work we do here will encourage that important discussion. I am looking forward to hearing the thoughts from the witnesses who are appearing before us today.

Thank you.